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[sent by e-mail]

7 May 2021

Re: Tax Treaty Policy Consultation

Dear Sir / Madam,

As representatives of the aviation leasing industry, we welcome the opportunity to respond to the public consultation by the Department of Finance on Ireland's Tax Treaty Policy. Aircraft Leasing Ireland (ALI) is the trade association representing Ireland's aviation leasing sector, launched in 2018 and comprising 32 members. Ireland is a global centre of excellence for aviation leasing with over 60% of the world's leased aircraft managed from here. Our primary objective is to maintain, support and develop this position.

Background to Aviation Leasing in Ireland

Since Tony Ryan established Guinness Peat Aviation in 1975, Ireland has become a world leader in the aviation leasing industry and a preeminent centre of excellence. Pre-Covid-19, it is estimated that an Irish-leased aircraft takes off from a runway around the world every two seconds. Irish lessors also own over 60% of the world's fleet of leased aircraft.

This industry is unique for several reasons: First, aircraft and aircraft engine leasing is a flagship financial services sector in Ireland and proof that Ireland can attract and retain decision-makers and be a global leader in finance. Second, it is a provider of highly skilled jobs, not just in Dublin but also in the Shannon region, with room for further regional expansion. Third, and despite the impact of the Covid-19 pandemic, air travel is forecast to recover and expand significantly in the next two decades, particularly in Asia - it is an industry with huge potential to grow. In fact, Irish lessors reported growth of 36% in fleet number in the five years from 2012- 2016 (statistic - PwC 'Taking Flight- 2018'). Furthermore, the proportion of the world's airline fleet which are financed by aviation lessors is expected to grow in the coming years and likely to surpass 50% globally (statistic – Airline Economics/KPMG – Industry Leaders Report 2021). This should present a significant opportunity for Irish based lessors.

The industry makes a significant contribution to the Irish economy, with a total contribution of $660m in 2016 and 4,970 FTE supported jobs. These jobs are provided directly through leasing companies, and indirectly through Maintenance Repair & Overhaul, legal, tax, audit and other professional services. The CSO estimates that direct employment in the industry grew by 275% between 2007 and 2016 (Sources: Central Statistics Office 'Aircraft Leasing in Ireland 2007 - 2016' and PwC 'Taking Flight - 2018').

Aviation Leasing and Tax Treaty Policy

One of the primary purposes of aviation leasing is to provide flexibility to airlines in respect of their financing and fleet options. The ability to lease aircraft and engines enables the establishment of new entrant airlines, allows airlines invest in new and used aircraft and assists the sale of aircraft globally. Aviation leasing will also play a key role in supporting airlines in their recovery from the impact of the Covid-19 pandemic, providing access to new aircraft and engines, preserving liquidity and avoiding extensive capital costs. Aviation leasing is a long-term business (with leases often for terms of 8-12 years) and double tax treaties provide long-term certainty and confidence to lessors when leasing to airlines.

Ireland's tax treaties are in general the envy of Irish aviation lessor competitors in the US, China, Hong Kong, Singapore, Qatar and the UAE. This is a testament to the long-standing commitment of successive Irish governments to expanding the number of Ireland's double tax treaties and equally as important, ensuring that Ireland's treaties are of a high quality and are competitive internationally. In this regard, over 80% of Ireland's double tax treaties provide for a zero-rate of withholding tax/income tax on aircraft lease rentals in the airline/lessee jurisdiction. However, in several key lessee jurisdictions, and in part due to the OECD BEPS Multi-lateral instrument ("MLI") treaty changes, Irish lessors now find themselves at an increasing competitive disadvantage due to the absence of a tax treaty (e.g., Indonesia, Brazil) or the existence of an outdated treaty (e.g., Japan, Australia). This is resulting in Irish aviation lessors losing opportunities.

In an aviation leasing context, the application of withholding tax to lease rentals gives rise to an increased operational cost for foreign airlines or aircraft operators as it is customary for lease agreements to include a gross-up requirement in respect of any withholding tax. The existence of withholding tax makes it more challenging for Irish based lessors to lease aircraft and engines to foreign airlines and aircraft operators (particularly in light of emerging and established competitive threats from e.g. the US, Hong Kong, Singapore, Qatar, the UAE and possibly the UK in the future). Given the global importance of the Irish aviation leasing sector, a broad and effective tax treaty network is of paramount importance to remove trade barriers in the form of foreign withholding tax and to afford airlines and aircraft operators the ability to finance the renewal and expansion of their aircraft fleet over the coming years.

Ireland's Tax Treaty Network

The expansion and improvement of the Irish tax treaty network is one of ALI's core objectives and since the establishment of ALI in 2018, its members have been particularly focused on the modernisation of existing and outdated treaties with Japan and Australia as well as the negotiation of a treaty with Indonesia. It is noteworthy that the Ireland/Japan and Ireland/Australia treaties are old and diverge significantly from the current OECD Model Treaty provisions which form the basis for more recent Irish treaties. It is also worth noting that prior to the establishment of ALI, these treaties were also a key focus of lessors given the importance of the respective markets and the issues that the treaty provisions/absence of a treaty present to both lessors and lessees. In addition to the above, ALI members are also focused on the following jurisdictions (in respect of which Ireland has no tax treaties).

- Brazil
- Argentina
- Colombia

A renegotiation of the Malaysian treaty would also be welcome in the medium term.

Response to Specific Consultation Questions

1. Economic Considerations

a) Does Ireland's tax treaty policy sufficiently cater for the evolving economic and business environment?

> Ireland's double tax treaty has been central to the success of the Irish economy, including the aviation leasing industry. However, it is critical that the Irish treaty network continues to evolve and expand as new competitive threats and indeed new market opportunities constantly emerge.

b) Do you have any suggestions on how could Ireland's tax treaty policy be enhanced, as a means to continue to facilitate economic opportunity into the future?

> ALI suggests that a focus is placed on competitive threats and that gaps in our treaty network by reference to those competitors are identified and, to the extent possible, addressed.
>
> From an aviation leasing perspective, the US and Hong Kong have good treaties with Japan and the US and the UK has good treaty with Australia. The Indonesian market is poised for significant growth as Indonesia has a large population and a rapidly growing aviation market. As a result, Indonesia will grow in its importance to Irish lessors in years

to come. In this regard, it is worth noting that the US and Hong Kong have treaties with Indonesia which offer significant relief from Indonesian withholding tax.

ALI also supports Ireland's continued reservation of its position regarding the changes to the definition of "Permanent Establishment" (as regards to playing the principal role leading to the conclusion of contracts) contained in the MLI. We note that this is consistent with the approach taken by most other EU and OECD Member States. Where possible, we would strongly encourage the Irish government to continue to reserve its position on the revised definition of Permanent Establishment in treaty negotiations.

c) Does Ireland's tax treaty network sufficiently serve all business sectors in the economy?

While Ireland has a very strong treaty network, there are gaps, relevant to our industry, highlighted above. These gaps ultimately allow for growth in the aviation leasing industry to occur elsewhere and by extension, reduce the growth of employment in Ireland. It is also important that Ireland's treaties serve the full spectrum of aviation leasing conducted from Ireland (i.e. airplanes, engines, helicopters).

d) How can Ireland optimise its tax treaty priorities in the context of recent international tax reforms, notably at the OECD?

ALI supports Ireland's commitment to the OECD BEPS process and believe that this will be key to the continued expansion of the Irish treaty network. The continued promotion of our substance-based regime will also be helpful as Ireland attempts to assuage reputational concerns.

e) What should the criteria be for prioritising the negotiation and renegotiation of specific tax treaties in the years ahead? Are there any significant gaps in Ireland's tax treaty network by reference to those criteria?

We appreciate that the current capacity levels for tax treaty negotiations/ re-negotiations may be limited and, therefore, we would be supportive of greater investment in the number of people working in this area being made. ALI and its advisers, PwC and KPMG, would be happy to support the Irish government in any further analysis needed to increase the number of high-quality tax treaties with other countries and in particular, to leverage our adviser's international networks for the counterparty data and information that will be critical to any such dialogue.

1. <u>Negotiation</u>

As noted above, market opportunities continue to evolve and should be used as a criterion for the prioritisation of the negotiation of treaties together with competitive threats. Ireland's treaty coverage in South America and Asia Pacific, both key markets, has some significant gaps and which are damaging when compared to Ireland's competitors in the aviation leasing industry – see below. These markets will be increasingly important in the coming years.

- Brazil (Singapore and the UAE have treaties)
- Colombia (the UAE has a treaty)
- Argentina (Qatar and the UAE have treaties)
- Indonesia (all competitors noted above have treaties)
- Cambodia (Hong Kong and Singapore have treaties)

2. <u>Renegotiation</u>

ALI suggests that outdated treaties which lack conformity generally with the current OECD Model Treaty should be a determining factor for prioritisation in terms of renegotiation. Both Japan and Australia fall into this category.

<u>2. Policy on Developing Countries</u>

a) Are there any specific areas of Ireland's treaty policy which should be modified or tailored, in relation to developing country?

> No obvious suggested amendments from an aviation leasing perspective. We would note that airlines in developing countries often struggle to access capital and newer technology aircraft. Over many years, aircraft lessors have supported airlines in developing countries in expanding their fleets with significant positive economic impacts for the relevant countries (e.g., in trade, tourism etc.).
>
> We would encourage the Irish government to continually expand Ireland's double tax treaties with developing countries, including with countries on the African continent.

b) Are there international best practices which Ireland can draw on to further enhance our approach to the specific circumstances of developing countries?

> See above regarding the role played by aviation lessors in helping to build the aviation infrastructure and economies of developing countries.

c) When negotiating with developing countries, should more emphasis be placed on the UN Model Treaty? If so, please provide details.

> Ultimately, the relevant bilateral discussions between the respective countries will determine this. From an ALI perspective, the OECD Model Treaty works well particularly when Article 8 is improved to extend to aircraft lessors. A number of Ireland's current treaties provide (consistent with the reservation of Ireland in the OECD Model Treaty in respect of Article 8) that profits derived from the operation of ships or aircraft in international traffic include profits derived from the rental of such assets on a bareboat basis if they are operated in international traffic. This approach effectively means that a lessor of ships or aircraft which are operated in international traffic will be exempt from tax in the source state irrespective of the existence of a permanent establishment therein. This is very helpful where foreign jurisdictions, notwithstanding Ireland's MLI position in relation to reduced permanent establishment thresholds (relating to playing the principal role leading to the conclusion of contracts), attempt to apply their desired MLI approach. A modified Article 8 also serves to remove trading barriers in the form of withholding tax for rentals referable to the international use of aircraft where the desired treaty partner insists on the inclusion of equipment rentals (and a rate of withholding tax) in Article 12 despite the current OECD Model Treaty (i.e., the absence of equipment rentals which has been the OECD policy for the last 20 years).

d) Should any specific standard positions, e.g. on source taxation, be adopted for treaties with developing countries?

> Where the UN Model Treaty is being used either in its entirety or together with the OECD Model Treaty, it will be very important from an aviation leasing perspective that Article 12 is aligned with the OECD Model Treaty (i.e., royalties should not cover equipment payments). Further and to the extent possible, continued negotiation of treaties having regard to Ireland's current reservation on Article 8 will be extremely helpful. Lastly, the taxation of gains arising on the disposal of aircraft should be reserved for the state of residence only.

We hope that the points outlined above will be of assistance. We acknowledge that Ireland is in the midst of discussions on the OECD/G20 Pillar One and Pillar Two frameworks and there is also significant dialogue at an EU level on agreeing further reforms to the international tax framework. Ireland itself has committed to opening a consultation on the possible move to a territorial system of taxation later in 2021. We would welcome further discussion on Ireland's tax treaty policy as soon as there is more clarity on the outcome of these various matters but in the meantime, we are available to discuss our recommendations and look forward to future opportunities to engage with you on Ireland’s tax treaty policy.

Yours faithfully

[sent by e-mail]

Declan Kelly
Chairperson